
A Framework for Strategic Alliance Partner Choice

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Existing theories identify elements of a firm's intangible value as possible reasons for alliance formation. However, the question of how firms come to know the extent of this intangible value is often not addressed. This study proposes that knowledge flows between organizations are the basis for identifying a partner firm's intangible value. This research suggests that alliances which overlap in their knowledge flows engage in longer lasting relationships.

Key Words: Strategic alliance, Transaction cost theory, Resource-based theory

Introduction

The use of strategic alliances is increasing as growing pressures from globalization and advances in technology force firms to look outside traditional boundaries for the resources and capabilities needed to compete. Knowing why firms choose one partner over another can help managers make informed partnering choices leading to increased success in firm performance.

A number of proposed theories have explained a firm's motivation for forming external partnerships (e.g. transaction cost and resource dependence theories). These theories explain why firms choose alliances over alternate forms of organization. However, they do not explain why firms choose certain partners over others. Each of the theories presupposes knowledge about what factors are responsible for the competitive advantage within potential partner organizations. Increasingly, however, a firm's competitive advantage is based on possessing assets that are hard to uncover and unlikely to be easily assessed during the partner evaluation process. This puts a firm at substantial risk for not being able to accurately assess the possible synergies resulting from an alliance.

This study proposes that pre-existing flows of knowledge between organizations influence the

likelihood of the forming of alliance relationships. These knowledge-flows provide firms with a unique lens through which they can assess some aspects of a firm's intangible value base and find partners with strategic, organizational and cultural fit. The identification of pre-existing knowledge-flows between organizations may be one means of narrowing the list of possible candidates, and increasing the likelihood of success in alliances.

This article is developed as follows: First, theoretical explanations that have been offered for why firms utilize alternative organizational forms are summarized. Gaps in the existing alliance formation theories are then discussed. Next, a framework and a series of propositions which utilize the learning-based approach are offered for use as a potential pre-alliance formation evaluation tool. Finally, implications and suggestions for research are provided.

Alliance Formation Theories and Pre-Formation Issues

Transaction Cost and Resource-Based Theories

Proposed theories explain a firm's motivation for forming strategic alliances, including transaction cost and resource-based theories. These theories explain why firms choose alliances over alternative forms of

organization, such as market-mediated contracts and acquisitions.

Transaction cost theory treats entry-mode choice as a decision motivated by a firm's desire to minimize transaction costs (Williamson, 1985). Proponents of transaction cost analysis argue that as firms strive to balance cost (efficiency) and control (protection) issues, a mix of hierarchies and markets will emerge to manage the transaction. The most appropriate governance mechanism is determined by three components: asset specificity, small numbers of transactors, and imperfect information.

Under specific conditions, cooperative arrangements provide an efficient organizational mechanism to prevent transactional hazards. Buckley and Casson (1988) identified the conditions which increase the likelihood that firms will choose cooperative arrangements over acquisitions: First, firms must need access to resources such as knowledge of a process or access to an embedded social network that cannot be acquired or replicated through traditional market-mediated contracts. Second, the cost of trying to acquire the targeted resources would be prohibitive since the firm would also pay for other unnecessary assets at the same time. Finally, Kogut (1988) noted that when high uncertainty over specifying and monitoring performance exists, inter-firm cooperative agreements create superior monitoring devices.

Resource-based theory represents an alternate view of entry mode choice that emphasizes resource accumulation as a possible source of enduring competitive advantage for firms (Penrose, 1958). This view of the firm rests on two assumptions for analyzing competitive advantage: First, firms may be heterogeneous with respect to the resources they control in the sense that they develop or accumulate resources differently over time because of their own unique histories. Second, many resources are imperfectly mobile, such as valuable land or access to unique raw materials, and can lead to sustained differences (heterogeneity) between firms that actually can grow over time (Barney, 1991). These resources can include tangible components such as plant, machinery and skilled personnel and intangibles such as reputation, specialized know-how of production processes, marketing expertise, and trade industry contacts (Wernerfelt, 1984). The lack

of unique, inimitable resources drives a firm's decision to seek external sources of assets that can provide a way for the firm to generate competitive advantage over time (Nelson, 1991).

Acquisitions and strategic alliances enable firms to trade otherwise non-marketable resources and/or to buy or sell resources in bundles (Wernerfelt, 1984). Acquisitions are argued to be more attractive for firms that can find unique non-imitable synergy between assets within their firms and those of acquiring firms (Barney, 1991). For example, AOL recently announced the acquisition of Bebo, a social networking site with a heavy concentration of global users and similar in scope to Facebook and My Space. The \$850 million acquisition is intended to leverage AOL's advertising sales and instant messaging communication infrastructure across Bebo's network, resulting in higher advertising revenue for AOL (Hempel, 2008). However, acquisitions ultimately increase the overall cost because management must spend more to get access to these resources and then must implement control mechanisms to monitor activity within the acquired firm. As an alternative to acquiring another firm, alliances offer faster and cheaper routes for increasing access to resources (Lei, 1993).

In a resource-based context, the choice of whether to enter through acquisitions or strategic alliances depends upon whether the resulting outcome of the relationship has the potential to be closely linked with (or is specific to) the firm's operations (Connor, 1991). The more closely aligned the resources of the external firm are to the existing firm's resource base, the more likely, a firm will choose acquisitions over strategic alliances (Hagedoorn and Duysters, 1997). Conversely, if there is a lack of specificity in asset bases between the existing firm and the external entity, strategic alliances may be more appropriate than acquisitions.

Pre-Formation Issues in Transaction Cost and Resource-based Theories

Theories of relationship formation presuppose that firms make value assessments prior to a relationship choice. Both transaction cost and resource-based theories help decision makers address which type of relationship a firm should enter based on several criteria. However, these theories do not say enough

about how firms assess the intangible assets of a potential partner.

More specifically, the transaction-cost explanation for why firms choose one relationship form over another depends on three components: asset specificity, small numbers of transactors, and imperfect information. This theory does not address the process involved in assessing the existence and degree of each component during the evaluation period prior to the merger. A firm would need access to valuable, internal information before it could assess the degree of specificity between firms, the level of tacit knowledge in existence, and the number of potential firms with the desired capabilities. If firms are not privy to this information up front, how can they provide an assessment of any of the three components?

Buckley and Casson (1988) suggest that, in the context of transaction-cost reasoning, firms choose alliances over acquisitions when asset need is specific, access cost is prohibitive, and uncertainty exists over how to assess performance. Each argument presupposes the existence of detailed knowledge about the existence and value of specific assets; such knowledge is often not known, even by the people within the targeted company. In large, diversified organizations, the extent of knowledge employees may have about the value in a specific part of the organization may be limited.

Resource-based theory suffers from some of the very same shortcomings. In the resource-based view, firms must have assets that partners value and are fit for use (Das and Teng, 2000). Indeed, those resources which are valued most by partners (such as knowledge and network relationships) are hard to trade in markets, rooted in developmental processes that are causally ambiguous, and have the potential either on their own or in combination to yield a

competitive advantage (Reid et al., 2001). While each of these paradigms assumes that firms possess the capability of assessing the existence and extent of intangible value within another firm, they provide little direction on how firms accomplish this task.

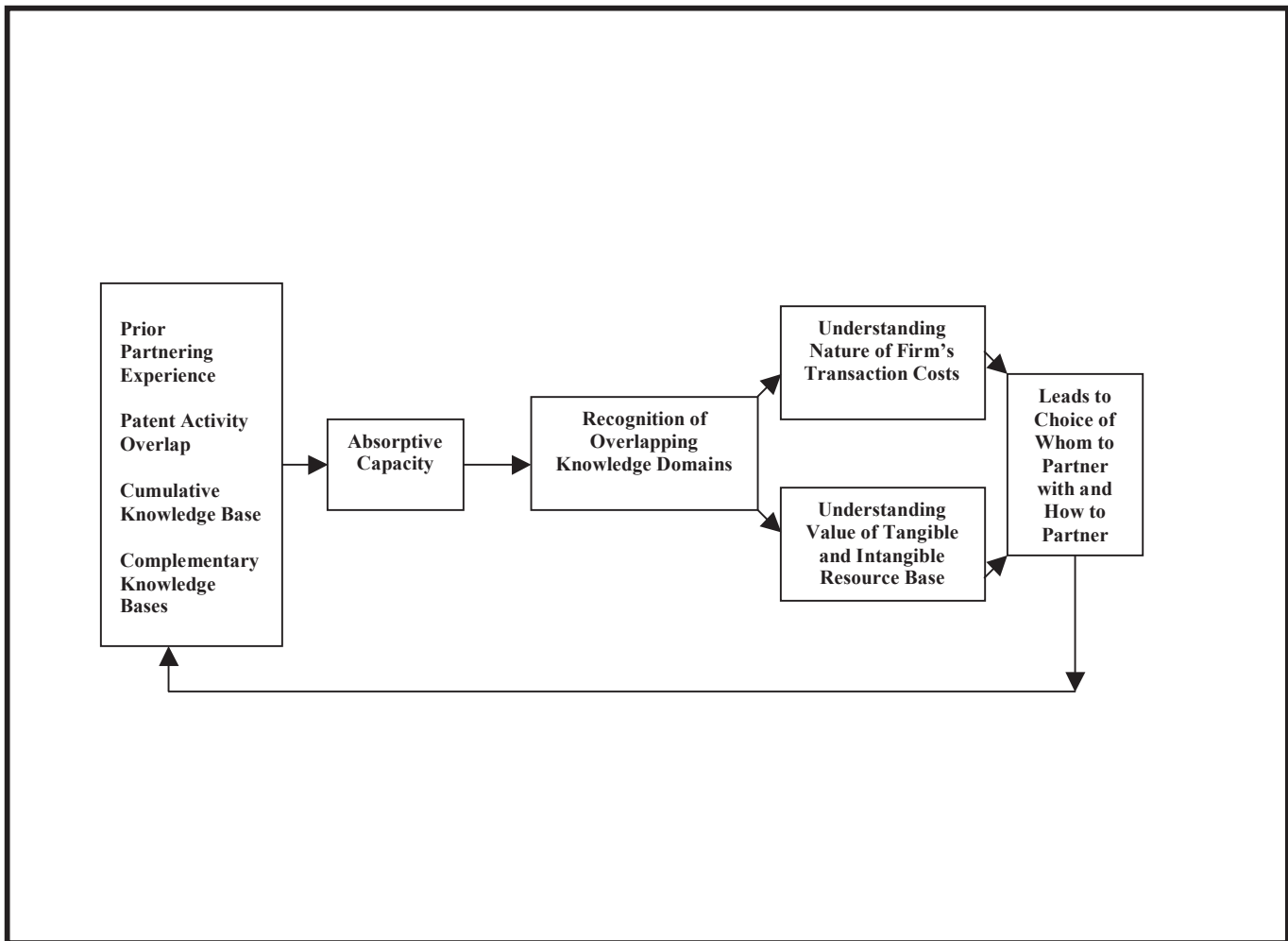
Theoretical Framework and Research Propositions

Theories are needed of how firms can accurately assess value prior to the choice of what form the relationship should take. Strategic alliances may represent an evolutionary path to asset valuation by providing an insider's view on the make-up of each other's asset base. Each theory needs an explicit discussion of a pre-alliance formation stage or process that can help identify the sources of a potential partner's assets.

The concept of absorptive capacity is offered as the foundation of a strategic alliance decision framework. It describes how firms should choose potential alliance partners (See Figure 1). Studies have used absorptive capacity to quantify a firm's capability to understand the relevance of external knowledge domains. Studies have also examined how knowledge in strategic alliances is managed, transferred, and developed, as well as its impact on performance (see Simonin, 2004). This study argues that firms which can identify the existence of overlapping knowledge between themselves and other firms are more likely to pursue external partnerships. Information on overlapping knowledge domains can provide unique insight into both transaction cost efficiencies and the source of a firm's intangible asset base. Firms that possess specific knowledge about potential partners may be able to reduce pre-alliance formation issues with both transaction cost and resource-based theories.

Figure 1

A Framework for Strategic Alliance Partner Choice



Cohen and Levinthal (1990) define the concept of absorptive capacity as a firm's ability to evaluate, assimilate and apply new external knowledge to a firm's operational environment. Mowery and Oxley (1995) conceptualized absorptive capacity as a broad set of skills needed to deal with the tacit component of transferred knowledge from the partner company and the need to modify this knowledge for the firm's own specific environment. Kim (1997) suggested that a firm's absorptive capacity was the ability to learn and apply this new knowledge to solving an organization's problems. The more knowledge a firm possesses in a particular field, the more likely a firm will understand the relevance of new

information and be ready to act (McMillan, Mauri and Hamilton, 2003). Industry experience, and experience with similar decisions, may increase the use of knowledge in decision-making (Brockman and Simmons, 1997; Brockmann and Anthony, 1998). Absorptive capacity is cumulative; previous knowledge increases the efficiency of a firm's absorptive rate. In this sense, firms that have searched for knowledge previously become even more efficient in their future knowledge searches.

The concept of absorptive capacity has previously been utilized to examine strategic alliance relationships. Gambardella (1992) found that

increased levels of absorptive capacity improve a firm's ability to exploit sources of technical knowledge outside its boundaries, and absorptive capacity has been found to affect the ability of partner firms to learn (Lane and Lubatkin, 1998). Dyer and Singh (1998) found that firms that have the ability to recognize and assimilate valuable knowledge from their partners tend to have overlapping knowledge bases and interaction routines that maximize the frequency and intensity of contact between partners. Research also indicates that research partnerships can improve a firm's level of absorptive capacity (Scott, 2003). George, Zahra, Wheatley, and Khan, (2001) found that firms with high levels of absorptive capacity tend to outperform firms that do not have this capacity.

None of these studies has looked at the possibility that a firm's existing level of absorptive capacity may actually influence its choice of alliance partner. Mowery, Oxley, and Silverman (1998) suggest that a firm's ability to absorb technological capabilities from its alliance partner depends on the pre-alliance relationship between the firms' patent portfolios. This study does not go beyond the patent portfolio activity to explore the possibility that a firm might share other types of knowledge such as production processes or marketing experience. Shenkar and Li (1999) found that firms in international joint ventures will tend to seek partnerships with firms sharing similar rather than supplementary knowledge bases. These studies suggest that a firm's knowledge boundaries tend to direct the search and, ultimately, the choice for potential alliance partners.

This research suggests that a firm's absorptive capacity, as represented by overlapping knowledge bases, provides a firm with a realistic appraisal of the intangible value of its partner. Overlapping knowledge boundaries make it easier for a firm to assimilate the value of the external knowledge because it falls within the firm's existing codes, routines and patterns for that knowledge. This research argues that it is the extent of the overlapping knowledge boundaries which ultimately determines the choice of partner firms.

In firms where there are complete identifiable knowledge overlaps, for example, we expect few, if any, strategic alliances because firms have little need to try to leverage the potential partner's knowledge

base. On the other hand, firms which pursue partnering activities with other firms possessing partial, but not complete, identifiable knowledge overlaps, have little need to probe the partner firm since the firm already has some knowledge about its intangible value. Partial overlapping knowledge bases also increase the possibility that firms encounter each other more frequently prior to entering an alliance, leading to increased understanding of the possible cultural fit between the two organizations. That is, a firm learns about its partner by interacting with it, and more frequent interactions increase the likelihood that trust will develop (Arino and De La Torre, 2000; Arino and Reuer, 2004). Trust has been found to be a positive influence on the performance of strategic alliance relationships (Jap and Anderson, 2003; Boersma, Buckley, and Ghauri, 2003) because when partners trust one another, the alliance can exist until all mutual goals have been attained.

When firms recognize the source and location of intangible knowledge, it is unlikely that they will attempt to acquire one another because they already have access to the value-creating areas within the partner firm. In this manner, firms with partial overlapping identifiable knowledge bases will limit the need to digest parts of the firm in order to gain access to the value-creating aspects of the partnering firm. This leads to the following propositions:

Proposition 1: Among firms which use knowledge-overlaps to direct their strategic alliance partner search, firms which share partial overlaps in their knowledge base are more likely to enter strategic alliances with one another than those who share complete knowledge overlaps.

Proposition 2: Among firms which use knowledge overlaps to direct their strategic alliance partner search, firms which share partial overlaps in their knowledge base are more likely to experience success in their strategic alliance relationships than those who share complete knowledge overlaps.

Firms which enter into strategic alliance relationships with other firms where no identifiable knowledge overlaps exist may use strategic alliance relationships as a probing mechanism to explore the intangible asset base of a firm. This intangible value is often identified as the ultimate source of competitive

advantage for firms, but is not readily transparent even to the most avid company observers. Firms entering into a relationship with the targeted firm hope that their insider status will offer them knowledge about what is ultimately responsible for a firm's competitive advantage. If firms are successful in ferreting out the source of a partner's competitive advantage and can identify ways to leverage that competitive advantage across their existing product markets, these relationships may often end up as acquisitions. On the other hand, if a partner's intangible assets are not valuable, firms may quickly end their relationship and search for a relationship with value-extending potential. This rationale may provide one explanation for the high failure rates that often plague strategic alliance relationships. This argument leads to the following propositions:

Proposition 3: Among firms that use knowledge overlaps to direct their strategic alliance partner search, firms which share no overlaps in their identifiable knowledge base will enter into higher numbers of strategic alliance relationships than firms which partially overlap in their knowledge base.

Proposition 4: Among firms that use knowledge overlaps to direct their strategic alliance partner search, firms which share no overlaps in their identifiable knowledge base will experience higher rates of failure in their strategic alliance relationships than firms which partially overlap in their knowledge base.

Implications and Future Research

This research is intended to augment both resource-based and transaction-cost formation theories by including an assessment framework based on the absorptive capacity concept for evaluating the nature and scope of the intangible value within a partnering firm. Focusing on knowledge flows as a means of determining possible overlap between partner firms can provide a framework for directing the evaluation stage in the partner selection process. When there is no identifiable overlapping knowledge, firms may actually engage in a probing behavior to determine the extent of the other firm's intangible resource base before committing themselves to a more substantial combined organizational form.

As the number of firms, and therefore, potential alliance partners grow in both quantity and scope, the proposed partnership evaluation framework should help companies identify alliance partners effectively and efficiently. Firms which pursue alliance relationships with an embedded knowledge component in place should experience successful relationships. Finding quantifiable data sources which reveal knowledge overlaps will further assist managers in their alliance selection process.

This study has implications for assessing strategic alliance performance. Traditional evaluations of strategic alliance performance have focused on the tenure of the alliance as a means of performance evaluation. This focus on the length of the relationship has led to the high estimates of failure within the alliance literature. Employing knowledge overlaps for a directed partner selection process should lower failure rates. Lowering the number of relationships entered into can lower operational costs and the risks associated with knowledge expropriation.

This study is limited in several respects. First, the inability to quantify various knowledge flows as a means for narrowing the field of potential alliance targets contributes to the speculative nature of the study. While the arguments have limited empirical support (e.g., Mowery et al., 1998), research should seek to empirically validate the use of knowledge overlaps as a guiding mechanism in alliance formation activities. Secondly, knowledge overlaps may represent robust explanations guiding the partner selection process and, thus, should not be ignored. Personal relationships between members of the top management teams of both inter- and intra-industry firms may be one major factor motivating partner selection that cannot be empirically quantified, except through qualitative interviews. This limits the generalizability of empirical results which may support the *probing behavior* explanation for alliance formation.

Research should focus on identifying specifically what types of knowledge overlaps lead to effective alliance relationships. For example, Mowery et al. (1998) identified the possibility that firms in non-technological-based alliances might share other types of knowledge overlaps that could provide some basis for the partner selection process. Knowledge

overlaps in areas such as board of directors' composition, institutional shareholder and banking relationship composition, and industry research group composition analyses may provide insight into the impact of interlocking relationships on alliance formation activity in non-technological relationships.

Research into the potential difference in acquisition rates among alliance partners should also be investigated. Significant differences in the acquisition rates between firms which share knowledge overlaps and those that do not may be an indication of the existence of the probing behavior. Anecdotal evidence linking past alliance activity and future acquisition behavior suggests a possible fertile area for strategic alliance research. By extension, the links between an organization's alliance targets and the use of competitive intelligence should also be explored. Firms which utilize formal planning and evaluation groups for identifying partners might provide a specific way of determining the probing intentions of potential partner firms.

The possibility that there is some practical limit to the value of knowledge overlaps needs to be further evaluated. Mowery et al. (1998) found that high levels of technological overlap seem to exert a diminishing influence on partner choice in an alliance. In these circumstances, firms would be less interested in acquiring other firms whose resource base duplicates that of their own. Research which evaluates the existence and threshold of the U-shaped influence on all types of knowledge overlaps would represent a substantial contribution to the alliance formation literature.

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